

200705031



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

NOV - 9 2006

UICs: 408.00-00
408.03-00
408.06-00

T:EP:RA:T3

LEGEND:

Taxpayer A =

Taxpayer B =

Company M =

Company N =

Company O =

Individual D =

Attorney E =

Individual F =

City S =

State T =

Amount 1 =

Amount 2 =

Amount 3 =

IRA X =

IRA Y =

Agreement A =

Dear :

This is in response to a ruling request dated , as supplemented by correspondence dated , and submitted on your behalf by your authorized representative, Attorney E, concerning the status of a contribution to your individual retirement account (IRA).

The facts upon which you base your requests are as follows.

Taxpayer A, a resident of State T, whose date of birth was , 1931, died on 2004 having attained age 73. At his death, Taxpayer A maintained several individual retirement arrangements ("IRAs") including IRA X maintained with Company M as custodian thereof. IRA X was set up on , at which time Taxpayer B, Taxpayer A's spouse, was the sole named beneficiary thereof. Taxpayer B remained the sole beneficiary of IRA X at Taxpayer A's death.

In , 1998, following discussions with Individual F, a representative of Company N, acting on behalf of Company M, Taxpayer A rolled over an amount approximating Amount 1 into IRA X, a pre-existing IRA. Thus, Amount 1 was added to the then IRA X account balance. Upon the advice of Individual F, Amount 1 was invested in certain mutual funds sponsored by Company M.

In , 1998, Taxpayer A wrote a letter to a representative of Company N questioning the performance of his investment in IRA X. Further correspondence regarding Taxpayer A's continued investment losses was exchanged between Taxpayer A and Company N until his death.

In pertinent part, Taxpayer A's letters to Company N alleged that Individual F's investment recommendations to Taxpayer A were not safe, were motivated by his desire to receive commissions, and were not made in the best interests of Taxpayer A. Furthermore, the letters alleged that "...these recommendations were not prudent nor appropriate for us at this time and do not meet our objectives of retirement".

Prior to his death, Taxpayer A neither initiated suit against either Company M or Company N in a court of competent jurisdiction nor was involved in an arbitration action with either company.

After the death of Taxpayer A, no court action or arbitration proceeding was initiated by either Taxpayer B or Individual D, her daughter, against either Company M or Company N.

On _____, which was after the death of Taxpayer A, Taxpayer B and Individual D, continued to exchange letters with Company N relating to the losses which Taxpayer A had suffered prior to his death with respect to his investment in IRA X. The letters exchanged included various settlement offers of Company N which were initially rejected by Taxpayer B. Approximately five months later, on _____, 2004, Company N increased its settlement offer to Taxpayer B to Amount 2. Taxpayer B then agreed to accept Amount 2.

On _____, Taxpayer B and Company N entered into Agreement A whereby Company N agreed to pay Amount 2 (an amount that did not exceed the losses incurred in Taxpayer A's IRA X) to Taxpayer B in full settlement of any and all claims Taxpayer B had against Company N relating to her deceased husband's, Taxpayer A's, investment in his IRA X.

On _____, Company N mailed a check, by means of overnight mail, in the amount of Amount 2 to Taxpayer B. Amount 2 was placed into several non-qualified (non-IRA) accounts where it remained as of the date of this ruling letter.

Subsequent to _____, Company M issued Taxpayer B a Federal Form 1099-MISC (Miscellaneous Income) showing "other income" in the amount of Amount 2.

Documentation in the file includes a letter which indicates that during calendar year 2000 the value of Taxpayer A's IRA X account was approximately Amount 3. Additionally, the _____ letter indicates that between 2000 and 2004, the value of the IRA X had declined by approximately Amount 2. As noted herein, the accepted settlement offer totaled Amount 2.

Neither Taxpayer A, Taxpayer B, nor Individual D was represented by counsel in his/her dealings with Company N relating to Taxpayer A's IRA X during the period _____ to _____. In this regard, Attorney E, your authorized representative, asserts on your behalf, that no representative of either Company M or Company N advised either Taxpayer B or Individual D of the tax ramifications of Taxpayer B's receipt of Amount 2. Rather, it has been represented on your behalf that during _____, the managing principal of Company M's City S, State T, office advised Taxpayer B to cash the Amount 2 check. Furthermore, it was not until Taxpayer B contacted Attorney E in _____, 2005, that she became aware that she might be able to roll over Amount 2 into an IRA.

On _____, 2005, Company N sent a letter to Attorney E advising him that all amounts referenced in Agreement A, Amount 2, related exclusively to Taxpayer A's IRA X.

On _____, 2004, which was approximately five months prior to the date of issuance of the above-referenced check, Taxpayer B, as beneficiary of Taxpayer A's IRA X, transferred all

amounts remaining in IRA X into an IRA set up and maintained in the name of Taxpayer B with Company M as custodian thereof. On or about _____, 2004, Taxpayer B transferred her IRA maintained with Company M, by means of a trustee to trustee transfer, into IRA Y maintained with Company O. IRA Y does not hold Amount 2.

Upon receipt of a favorable letter ruling from the Service, Taxpayer B intends to contribute Amount 2, received under the _____ Agreement referenced above, to her IRA Y.

Based upon the foregoing, you request the following rulings:

1. That Amount 2 received by Taxpayer B from Company N pursuant to the above described Agreement A is eligible to be rolled into IRA Y, an IRA set up and maintained in the name of Taxpayer B, and such rollover will constitute a valid rollover transaction within the meaning of section 408(d)(3)(A)(i) of the Internal Revenue Code; and
2. that the Internal Revenue Service waive the 60-day rollover requirement with respect to the contribution of Amount 2 into IRA Y because the failure to waive such requirement would be a hardship and against equity or good conscience.

With respect to the requested letter rulings, section 408(a) of the Code provides that, for purposes of this section, the term "individual retirement account" means a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries, but only if the written governing instrument creating the trust meets certain requirements. Among these requirements is the one found in paragraph (1) of section 408(a) which states that, except in the case of a rollover contribution described in subsection (d)(3), in section 402(c), 403(a)(4), 403(b)(8), or 457 (e)(16), no contribution will be accepted unless it is in cash, and contributions will not be accepted for the taxable year in excess of the amount in effect for such taxable year under section 219(b)(1)(A) on behalf of any individual.

Section 408(d)(1) of the Code provides the general rule for the tax treatment of distributions from IRAs. This section provides, in pertinent part, that except as otherwise provided in subsection (d), any amount paid or distributed out of an individual retirement plan or under an individual retirement annuity shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.

Section 408(d)(3) of the Code establishes an exception to the contribution rules of section 408(a)(1) and the income inclusion rule of section 408(d)(1) for certain transactions characterized as rollover contributions. Under section 408(d)(3), an amount is described in paragraph (3) as a rollover contribution if it meets the requirements of subparagraphs (A) and (B).

Subparagraph (A) of section 408(d)(3) of the Code states, in pertinent part, that paragraph (1) of section 408(d) does not apply to any amount paid or distributed out of an individual retirement account or individual retirement annuity to the individual for whose benefit the account or annuity is maintained if -- (i) the entire amount received (including money and any other property) is paid into an individual retirement account or individual retirement annuity (other than an endowment contract) for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution.

Subparagraph (B) of section 408(d)(3), in short, provides that this paragraph does not apply to any amount described in subparagraph (A)(i) received by an individual from an IRA account or annuity if at any time during the 1-year period ending on the day of such receipt such individual received any other amount described in that subparagraph from an IRA account or annuity which was not includible in his gross income because of the application of this paragraph.

Section 408(d)(3)(D) of the Code provides a similar 60-day rollover period for partial rollovers.

Section 408(d)(3)(E) of the Code provides, in general, that paragraph 408(d) does not apply to any amount required to be distributed under subsection (a)(6).

Section 408(d)(3)(I) of the Code provides that the Secretary may waive the 60-day requirement under sections 408(d)(3)(A) and 408(d)(3)(D) of the Code where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement. Only distributions that occurred after December 31, 2001, are eligible for the waiver under section 408(d)(3)(I) of the Code.

Revenue Procedure 2003-16, 2003-4 I.R.B. 359, (January 27, 2003) provides that in determining whether to grant a waiver of the 60-day rollover requirement pursuant to section 408(d)(3)(I), the Service will consider all relevant facts and circumstances, including: (1) errors committed by a financial institution; (2) inability to complete a rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country or postal error, (3) the use of the amount distributed (for example, in the case of payment by check, whether the check was cashed); and (4) the time elapsed since the distribution occurred.

With respect to the initial requested letter ruling, Taxpayer A and, after his death, Taxpayer B and Individual D, engaged in an exchange of letters with Company N relating to a significant loss in value of Taxpayer A's IRA X, described in Code section 408(a), in which Taxpayer A alleged that he received inappropriate advice from Individual F and that the advice was motivated by Individual F's desire to generate stock purchase transactions to generate commissions. Pursuant to Agreement A, Taxpayer B recovered Amount 2 from Company N which she subsequently placed into several non tax qualified (non- IRA) accounts where it remains.

As the , 2005 letter from Company M to Attorney E indicates, the above referenced settlement proceeds, Amount 2, related exclusively to Taxpayer A's IRA X.

The initial issue presented in this case is whether the Service should treat Amount 2 as replacing losses suffered by Taxpayer A's IRA X prior to his death and, as a result, not treat its intended contribution to Taxpayer B's IRA as an ordinary contribution subject to the limitations of Code sections 219 and 408.

A determination of whether settlement proceeds should be treated as a replacement payment, rather than an ordinary contribution, must be based on all the relevant facts and circumstances surrounding the payment of the settlement proceeds (see Revenue Ruling 2002-45, 2002-2 C.B. 116, which applies a facts and circumstances test to determine whether a payment to a qualified plan under Code section 401(a) is a restorative payment to a plan as opposed to a plan contribution. We believe that it is appropriate to apply the reasoning of Rev. Rul. 2002-45 to IRAs).

As a general rule, payments to an IRA are restorative payments only if the payments are made in order to restore some or all of the IRA losses resulting from breach of fiduciary duty, fraud or federal or state securities violations (such as payments made pursuant to a court-approved settlement or independent third party arbitration or mediation award.) In contrast, payments made to an IRA to make up for losses due to market fluctuations or poor investment returns are generally treated as contributions and not as restorative payments.

In the instant case, as noted above, there was an exchange of correspondence between Taxpayer A, Taxpayer B, Individual D and Company N relating to the IRA X losses that reflects at least some of the negotiations between the parties. The facts and circumstances of this case indicate that Company N was negotiating in an effort to settle a potential liability arising out of unsuitable investment recommendations by its representative, Individual F, in connection with losses incurred by Taxpayer A with respect to IRA X.

Accordingly, from the facts presented in this case, the payment from Company N to Taxpayer B was the result of an arm's-length settlement of a good faith claim of liability, and, as such, is a restorative payment rather than an additional contribution to an IRA made to merely replenish the IRA account balance after investment losses. This conclusion is not altered by the failure of either Taxpayer A or Taxpayer B to either file a lawsuit or seek arbitration.

Therefore, based on the specific facts and representations contained herein, we hold that Amount 2 received by Taxpayer B from Company N, pursuant to the above-reference settlement Agreement A, is eligible to be rolled over into IRA Y, an IRA set up and maintained in the name of Taxpayer B.

Thus, with respect to your first ruling request, we conclude as follows;

1. That Amount 2 received by Taxpayer B from Company N pursuant to the above described settlement does represent IRA X replacement amounts eligible to be rolled over into another IRA.

With respect to your second ruling request, the information presented and documentation submitted by Taxpayer B is consistent with her assertion that her failure to accomplish a timely rollover was caused by her receiving inappropriate advice from Company M. In this regard, we note that Taxpayer B was issued a Form 1099-MISC in lieu of a Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs Insurance Contracts, etc., and that the managing principal of an office of Company M advised Taxpayer B merely to cash the settlement proceeds check. We also note that there is a dearth of authority as to when payments similar to that received by Taxpayer B would be considered a restorative payment and not a regular IRA contribution, and that it was not until 2005, that Taxpayer B was advised by Attorney E that Amount 2 may have been a restorative payment with respect to IRA X and, as such, eligible to be rolled over into IRA Y.

Therefore, pursuant to section 408(d)(3)(I) of the Code, the Service hereby waives the 60-day rollover requirement with respect to the receipt of Amount 2 by Taxpayer B from Company N which amount represented IRA X assets. Taxpayer B is granted a period not to exceed 60 days as measured from the date of issuance of this ruling letter to contribute an amount not to exceed Amount 2 into IRA Y or another Rollover IRA set up and maintained in the name of Taxpayer B. Provided all other requirements of section 408(d)(3) of the Code, except the 60-day requirement, are met with respect to such contribution, the contribution of Amount 2 into such an IRA will be considered a rollover contribution within the meaning of section 408(d)(3) of the Code.

This ruling does not authorize the rollover of amounts that are required to be distributed by section 401(a)(9) of the Code (made applicable to an IRA under Code section 408(a)(6)), if any.

This ruling letter is based on the assumption that Taxpayer A's IRA X was and is described in Code section 408(a) as represented at all times relevant thereto. It also assumes that the contributory IRA, IRA Y, set up and maintained in the name of Taxpayer B, described above, meets the requirements of Code section 408(a) as represented. Additionally, it assumes the correctness of all facts and representations made with respect thereto.

A copy of this letter has been sent to your authorized representatives in accordance with a power of attorney on file in this office.

200705031

If you have any questions concerning this letter ruling, please contact
Esquire (ID: -) who may be reached at 202- - (not a toll-free number) or
202- (FAX).

Sincerely yours,



Frances V. Sloan, Manager,
Employee Plans Technical Group 3

Enclosures:
Deleted copy of this letter
Notice of Intention to Disclose